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SUBJECT: EUROPEAN COMMISSION PROPOSES SWEEPING TELECOM REFORM
PACKAGE

11. (SBU) SUMMARY AND INTRODUCTION. The European Commission adopted proposals on November 13, 2007 for a major reform, the so-called E-Communications Framework Review, of the EU's telecommunications regulatory framework. The Commission's goals with the package include promoting competition within the electronic communications sector, improving regulatory efficiency, boosting investment, freeing up the use of spectrum resulting from the "digital dividend" and rationalizing use of spectrum generally, enhancing consumer rights, expanding citizen accessibility to broadband and other e-services, and increasing e-communications security. The package took shape only after fierce debate within the Commission over the issues of possible functional separation remedies and the creation of a new E-Communications Market Authority.

12. (SBU) The package is designed to overhaul existing EU telecom rules in response to advances in technology and markets. In the package, the Commission adopted a Recommendation immediately reducing from 18 to seven the number of telecoms markets national regulators should oversee. The remainder of the package requires European Parliament and Council approval, which the Commission seeks by 2009. Member state implementation would follow by late 2010. The Commission views the telecoms package as a key element of its internal market review, part of its goal of promotion of growth and jobs through Lisbon Agenda reforms and completion of the EU internal market. Nevertheless, many proposals face strong opposition from key member states and incumbent telecom providers, which could result in the scaling back of any final reform. Post will report separately on the potential impact of telecoms package reforms on U.S. firms and investment. END SUMMARY AND INTRODUCTION.

BACKGROUND: UPDATING THE UNWIELDY 2002 REGULATORY FRAMEWORK

13. (U) The EU introduced a new telecommunications regulatory framework in 2002-03 via the Electronic Communications Framework Directive (2002/21/EC), hereafter the Framework Directive, which entered into force in July, 2003. This framework was: a) a response to technological developments and increasing convergence of communication devices; b) based on a principle of technology neutrality; and c) designed to respond to future developments. The core of the framework consisted of five Directives, with several other pieces of legislation and a Recommendation on markets also part of the package. The framework laid out guidelines for EU state

National Telecom Regulatory Authorities (NRAs) to develop regulations to apply to all services transmitted electronically, whether wireless or fixed, Internet-based or circuit switched, data or voice, etc.

¶4. (U) A key part of the framework is the expectation that national regulators, in consultation with competition authorities, conduct reviews of 18 separate telecoms markets. The method for this approach is the Article 7 procedure of the Framework Directive (2002/21/EC). Under this procedure, NRAs are expected to analyze markets listed in the Recommendation, taking into account national circumstances, to define market boundaries and assess whether one or more players is dominant or has significant market power (SMP).

¶5. (U) When an NRA determines that significant market power (SMP) exists, it must propose appropriate regulatory remedies and notify the Commission Directorate General for the Information Society (DGINFSO). DGINFSO can reject the proposed market definition and SMP analysis but not veto or block the remedies. The entire requirement, that NRAs review 18 markets in each of 27 member states, resulted in a total of 695 distinct proceedings being reviewed by the Commission as of mid-November 2007.

THE NEW REVIEW PROPOSALS -----

¶6. (U) The 2002 rules called for the Commission to conduct periodic reviews of the framework operation. The Commission opened a public consultation on the issue in late 2005 and used the input to prepare the current reform proposals. The new package, formally the E-Communication Framework Review, was released on November 13, 2007. It contains two proposals amending existing Directives and one proposal for a regulation to establish an EU-wide regulatory authority. Specific proposals are as follows:

BRUSSELS 00003391 002 OF 005

-- A Proposal for a Directive amending the Universal Service Directive (Directive 2002/22 EC) and the e-privacy directive (Directive 2002/58 EC).

-- A Proposal for a Directive amending the general framework Directive (Directive 2002/21 EC), the access Directive (Directive 2002/19 EC) and the authorisation Directive (Directive 2002/20 EC).

-- A Regulation of the European Parliament and of the Council establishing the European Electronic Communications Market Authority (EECMA).

¶7. (U) These core proposals are accompanied by the Commission's new Recommendation on Relevant Markets, applicable immediately, and a document on spectrum policy. These and the other major areas of reform proposed in the package are discussed below.

FUNCTIONAL (STRUCTURAL) SEPARATION -----

¶8. (U) The Commission proposal would give national regulatory authorities the possibility of imposing functional separation on incumbent infrastructure and the service providers (differing from the forced separation that the U.S. imposed upon AT&T in the 1980s). The proposal stops short of requiring ownership unbundling (e.g. forced sale of service provider or infrastructure units), in contrast to recent energy sector proposals that would mandate ownership separation. The telecom proposal would allow national regulators to impose functional separation as a last resort if they "deem it necessary to tackle important competition problems." Under the plan, NRAs must seek approval from the Commission and need to take into account the effect on investment by the incumbent as well as by new market entrants. The proposal would require NRAs to conduct a thorough cost-benefit analysis (for both the operator and the NRA, given the complexities of the remedy) before introducing functional separation.

¶9. (U) The Commission cited continuing competition problems in the fixed voice telephony and broadband markets in introducing the

proposal, noting that on average 87.8% of fixed-line subscribers still use incumbent networks for access. The Commission pointed to successful cases of functional separation in the UK, Australia and New Zealand in defending the plan. The Commission said that "this remedy enhances overall investment in services and network infrastructures," noting that UK functional separation spurred a wave of infrastructure-based market entry and an explosion of local loop unbundled lines from 2005-07.

¶10. (SBU) Functional separation has generated the fiercest resistance of any of the telecom proposals. Even before the plan's release, media cited an internal Commission split over the idea, with officials from the Commission's Directorates General for Competition (DG COMP) and Internal Markets (DG MARKT) quoted as saying functional separation was unnecessary and could harm investment in telecom networks. This dispute appears to have been quelled by internal Commission agreement that the remedy would be an optional, last-ditch measure, subject to Commission approval.

¶11. (SBU) Opposition to functional separation has also emerged from many incumbent telecoms operators and several member state governments. The European Telecommunications Network Operators' Association (ETNO), representing incumbent operators, criticized the proposal harshly, stating that "mandatory functional separation risks...increased costs for access and less investment in new and alternative networks, thereby reducing long-term network competition and limiting consumer choice."

¶12. (SBU) Major national incumbents quickly attacked the proposal. France Telecom's Director of Regulatory Affairs, Jacques Champeaux, said functional separation "is a real risk for next-generation networks," adding that the measure would create dedicated companies operating network businesses, amounting to new monopolies. Didier Bellens, head of Belgian incumbent Belgacom, said EU backing of Belgian regulator efforts to force Belgacom to open its broadband fiber network to competitors would hurt investment. The board chair of Slovene incumbent Telekom Slovenije echoed this sentiment, saying "if we have to offer fibre to competition, what will be our advantage in investing in fibre?"

BRUSSELS 00003391 003 OF 005

¶13. (SBU) Support for the proposal emerged from several quarters, however. ECTA, a lobby group for new operators such as Colt and Virgin Media, said the proposal would speed broadband development. ALTO, representing Irish telecom operators, also backed the proposal, calling it a "move towards a more competitive telecommunications market in Europe." The Financial Times editorialized in favor of functional separation, citing how the UK example has improved access for rival providers, promoting greater competition and broadband use.

A EUROPEAN ELECTRONIC COMMUNICATIONS MARKET AUTHORITY

¶14. (SBU) The Commission's proposed European Electronic Communications Market Authority's (EECMA) would have two key roles, the most important one being the development of a consistent regulatory framework across the EU-27. To achieve this, the Commission proposes that EECMA assume the role of the European Regulators Group (ERG), an advisory group to the Commission which consists of National Regulatory Authorities (NRAs). According to the Commission, this loose form of cooperation has failed despite many efforts and good intentions. EECMA would be given power to veto NRA decisions. EECMA's second task would be to increase information security by absorbing the independent European Network and Information Security Agency (ENISA), which since operated since September 2005 and is based in Heraklion, Greece.

¶15. (SBU) The Commission's goal is to use the EECMA to "ensure greater consistency of approach amongst Europe's regulators, both in the types of remedy used and in the timescales applied." The reform proposals would empower the Commission to act on EECMA's advice to tell national regulators when and how particular regulation should be applied, including requiring regulators to accelerate imposition of new measures. EECMA would deliver expert opinion to the

Commission on specific national regulatory proposals, with the Commission having the final say. EECMA would also review fewer telecom markets (see below), reducing the burden on national regulators. The goal is to converge toward a single pan-EU market, and produce "less, but more effective and faster regulation."

¶16. (SBU) Reaction to the EECMA proposal also has been predominantly negative. The ERG, representing NRAs, attacked the idea, saying a new regulator would add new layers of unnecessary centralism. Ed Richards, CEO of OFCOM, the UK telecoms regulator, opposed EECMA as well, noting in an FT editorial that "centralisation of power in Brussels, plus a new European bureaucracy, is not the answer..." Richards added that a central regulator could undermine proposals designed to reinforce independent regulation at the national level. Germany Deputy Economy Minister Bernd Pfaffenbach said the creation of a new EU body "would go against the principle of subsidiarity," (keeping EU decisionmaking as locally-based as possible), and runs counter to EU deregulation goals.

¶17. (SBU) The head of ARCEP, the French NRA, said that creation of EECMA would alter the relations between the Member States and the European institutions. France Telecom officials also spoke out publicly against the proposal. The same FT editorial that supported functional separation opposed EECMA, calling the idea "a one-size-fits-all strategy." Little opposition has surfaced to the incorporation of ENISA, though it remains unclear what actual synergies of such a move might be.

REDUCTION IN THE NUMBER OF REGULATED MARKET SEGMENTS

¶18. (U) As part of the reform, the Commission adopted a new Recommendation on Relevant Markets, effective November 13, that reduces from 18 to seven the number of telecom markets where "ex ante" (prior) regulation by NRAs is required. The Commission explained that it removed most of the retail markets (e.g. for landline or mobile services) since "effective wholesale regulation, checked by the Commission, serves in all EU member states to protect retail users." The Commission also removed some wholesale markets after most NRAs found these markets competitive. The remaining seven markets include access to and call origination on fixed networks, wholesale local loop and broadband access, and others. The Commission stressed that this reform will cut in half the

BRUSSELS 00003391 004 OF 005

regulatory burden on member states.

¶19. (U) Most commentary on this proposal has been positive, with analysts viewing the step as a significant liberalization. ETNO, however, stated that it "strongly regrets that the list proposes to extend wholesale regulation to any new network."

SECURITY

¶20. (SBU) The Commission identified network and information security as a priority of the Telecoms reform, citing increasing threats to internet and telecom networks from organized cyberattacks, viruses, malware, spam and other criminal activities. The Commission therefore proposes that the EECMA focus on network and information security as a core task, using incorporated ENISA staff, to coordinate EU-wide responses to security threats. EECMA would appoint a Chief Network Security Officer to lead such functions, supervising exchange of security information, training and best practices across the EU.

RATIONALIZATION OF SPECTRUM MANAGEMENT

¶21. (U) The Commission also seeks to move towards a common spectrum plan at the EU level, saying this will increase spectrum efficiency beyond that achievable at the national level. The Commission notes that existing radio spectrum allocation was done decades ago, is inconsistent across member states, and is highly inefficient, resulting in only 50 percent of spectrum being used at any point in time.

¶22. (U) The Commission therefore proposes to start preparatory work on a binding Community law instrument to adopt a spectrum clustering decision. This clustering of spectrum would apply to the main part of the "digital dividend" - the UHF band - that will be freed up by the switch from analog to digital TV broadcasting (which is to be completed by 2012 for most member states). The Commission notes that a digital channel uses 6-15 times less spectrum than an analogue channel. The Commission seeks to use spectrum freed after the switchover for interactive digital TV, expanding wireless access to broadband (especially for rural areas), and mobile multimedia services. The spectrum clustering effort may meet member state resistance, given the potential impact on uses of spectrum for national security purposes, and potential resistance from existing broadcasters.

¶23. (SBU) The Commission is proposing to make the principle of technological neutrality in the use of spectrum binding. In addition, it is proposing the introduction of the principle of service neutrality. These principles are to be accompanied by a procedure allowing exceptions in order to avoid interference, or in order to "protect public health against electromagnetic fields", or on public interest grounds. The Review also proposes the EU-wide legalization of spectrum trading, but leaves the mechanisms to be used for the Commission to determine at a later date.

¶24. (SBU) The proposals list a series of important areas of spectrum harmonization where the Commission would be empowered to act. Together, these proposals would represent a significant increase in EU powers over spectrum - currently jealously guarded by national governments and regulators.

COMMENT - LEGISLATIVE PROCESS AND TIMING

¶25. (SBU) Parliament is working to assign rapporteurs for the legislative proposals, and plans to move forward on review of the proposals in early 2008. The Telecoms Council will begin consideration of the proposals at its November 29 meeting. Council discussions are expected to be very conflictual, given strong opposition to the functional separation and EU regulator elements of the plan already expressed by officials in France, Germany and elsewhere. This opposition will test the ability of the Commission, and Information Society and Media Commissioner Reding in particular, to persuade key member states of the benefits of these reforms.

¶26. (SBU) Many sources indicate Reding and other Commissioners see

BRUSSELS 00003391 005 OF 005

the telecoms package as a key component of the internal market review, part of the Commission's strategic goal of promotion of growth and jobs through Lisbon Agenda reforms and completion of the EU internal market. The Reforms are also a "legacy" issue the Commission would like to count among its achievements when its term ends in 2009. Nevertheless, given the strength of opposition to key parts of the telecoms package, it is likely any final reform will be scaled back. It also remains to be seen how effective reform transposition into national law, expected to occur by late 2010, will be.

¶27. (U) Post will report separately on the potential impact of telecoms package reforms on U.S. firms and investment.

GRAY